THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

National Intelligence Council

DDI #5042-82
17 June 1982

MEMORANDUM FOR: Director of Central Intelligence

FROM : [redacted] 25X1
Acting National Intelligence Officer for USSR-EE

SUBJECT : NSC Meeting, 18 June 1982

1. The purpose of the meeting is to reconsider the oil and gas sanctions in light of the Versailles summit, as generally anticipated at the previous meeting on this issue on 24 May. An NSC staffer has informed me that the envisaged NSC Options paper (to be Attachment 2 if received) will present four Options:

--Maintain the sanctions.

--Attempt extraterritorial pursuit to prevent European companies [redacted] from circumventing the US embargo). 25X1

--Rescind the sanctions.

--Rescind the sanctions on the Sakhalin project only.

2. On the basis of my discussions with various staffers, I believe that the lineup will be similar to the one at the 24 May meeting:

--State, Treasury, and Commerce will argue for lifting the sanctions related to the pipeline and Sakhalin; as a fallback Commerce will argue for extraterritorial pursuit to prevent European companies from cashing in on US business losses while State will argue for at least the lifting of the sanctions affecting the Sakhalin project.

[redacted]

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--JCS may support the State position in order to further the Allied unity needed to implement defense plans.

--NSC and OSD will argue for at least maintaining the sanctions. For the reasons spelled out below, I recommend that you take this position also.

--NSC may suggest extraterritorial pursuit but I recommend against this course.

3. State is likely to base its case on (1) our inability to stop the pipeline and (2) European expectations that we would lift the sanctions in exchange for their willingness to have the Versailles communique mention the need for prudence in financial dealings with the USSR and for transparency in those dealings. As you know the Secretaries of State and Treasury have been portraying this language as a breakthrough. Schmidt and Mitterand have publicly stated that this language does not mean any change in their policy--assertions which are supported by neutral observers such as The Economist (See Att 3). My own view is transparency will be a real step forward if it materializes but that nothing concrete has been accomplished yet.

4. Some may argue that maintenance of the sanctions will shut US business out of further lucrative deals. That is a specious argument. In the first place, Soviet concern about US embargoes will not be allayed by a lifting of sanctions now: The price of leadership for the US is that the USSR will prefer commercial deals with more pliant partners. Secondly, US ability to make desired sales will continue to depend either on superior technology or on providing a product the Soviets cannot get elsewhere. The Soviets had no compunction about jumping back into the US grain market and today would still prefer the GE rotors if they could get them. [redacted] 25X1

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25X1 [redacted] Overall then, neither the maintenance or lifting of sanctions will materially affect future Soviet purchasing decisions.

5. The real question is what effect the decision on sanctions will have on the present or any further Soviet-European gas deals. As you know, we believe that our sanctions can make the pipeline more expensive and less efficient but not block it at this stage. Further, as the CIA study (Annex A) makes clear, Western Europe needs additional gas in the 1980s; the pipeline

deal provides that increment and it is unlikely that the West Europeans will reverse course now. However, the maintenance of strong US opposition to the pipeline (at a cost of some business losses to US firms) will give encouragement to Europeans who opose the deal and may result in countries which have not yet signed contracts [redacted] buying less gas than 25X1 originally envisioned or, as a slim outside possibility, not buying any at all. The net effect, then, is to make the project less remunerative for the Soviets--certainly not the optimum outcome but the best that can be expected at this point.

6. Future Soviet-European energy dealings will depend in large part on what alternative sources the Europeans can find for their additional requirements. Our study and the SNIE (Annex B) both make clear that (1) there are additional European gas requirements in the 1990s and (2) any alternative will be more costly than Soviet gas. Given the natural European inclination to buy as cheap as possible and the Soviet willingness to sell as cheap as possible to obtain both hard currency and political leverage, the most likely outcome would be more purchases from the Soviet Union. But here, the US can make a difference: first, by continuing to point out the insecurity of relying on the Soviets; second, by working with the Europeans on alternatives; and third, by conveying to them our strong and continued opposition, in word and deed, to increasing European dependency on Soviet energy.

7. In effect, for the Europeans the question boils down to the price they are willing to pay for security. If commercial terms alone are considered, the answer is that the Europeans are not likely to pay the price necessary to avoid more Soviet purchases. However, if the political cost of alienating the US is added, then the Europeans may well be willing to pay the price. European perceptions of that potential political cost will most likely be affected negatively by the lifting of sanctions since the argument could be that the US may be opposed to European dealings with the Soviets but, in the end, will back off if the Europeans carry on anyway.

8. Taking this line of argument further, one might be encouraged to attempt extraterritorial pursuit. Here, however, I believe the effects would be entirely negative. First, the attempt would probably fail. Seocnd, even if it succeeded, the pipeline would be built because of the high priority the Soviets attach to it and their ability to build it from domestic resources if need be--a costly but possible alternative for them. Third, and most important, in the process of trying

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extraterritorial pursuit, we would start a major political dispute and jeopardize the prospects for coming up with Western alternatives to Soviet natural gas. [redacted]

25X1 [redacted] The problem is that such retaliation would affect other countries who were more forthcoming [redacted] who are already suffering because of the sanctions, who may have resigned themselves to those sanctions [redacted] but who would become highly irritated by US extraterritorial pursuit of any participant in the project. Consequently, I recommend that you oppose any suggestion that the US attempt extraterritorial pursuit.

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9. The Sakhalin issue is simpler. The only commercial effect of sanctions right now is to delay exploration of the Odoptu field by at least one year. [redacted] 25X1

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10. In sum, I recommend that the sanctions be maintained in effect for the following reasons:

- --The sanctions were imposed to make the Soviets pay a price for the repression in Poland; repression there continues and the sanctions are having at least part of their desired effect by making both the pipeline and Sakhalin projects more difficult and costly to the Soviets (at some cost to Western firms as well but that seems an acceptable price for opposing Soviet aggression).

- --Lifting the sanctions would give the Soviets the wrong message about the constancy of US policy and would undercut those Europeans and Japanese who have either supported the sanctions or opposed the energy deals with the Soviets.

--Maintaining the sanctions will underscore our efforts to have our allies concentrate on developing alternatives to Soviet gas.

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NSC MEETING

18 June 1982

Attachments:

1. Talking Points for the DCI
2. NSC Options Paper
3. Economist Editorial on Versailles Summit

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Annexes: (Background Reading)

A. Energy Study with NSC Executive Summary
B. SNIE on Western Energy Alternatives to Soviet Gas

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NSC Meeting on the December 30, 1981 Sanctions on Oil and Gas Equipment to the Soviet Union

In the NSC meeting of May 24, the President deferred a decision on whether to maintain, rescind, or extend the December 30 sanctions until after the Versailles and Bonn Summits. Nevertheless, he used the occasion of the meeting to indicate his general views on this subject. Among the views expressed at the meeting were:

1. The purpose of the December 30 sanctions was to advance reconciliation in Poland through concrete measures.

2. The initiative on East-West credits is solely linked to consideration of extraterritorial controls on oil and gas equipment.

3. Concern that U.S. credibility would be undermined by relaxing the sanctions prior to substantial improvement in the Polish situation and a meaningful allied agreement on credits.

4. A desire to persuade the Allies to move forward with the development of North Sea gas reserves on an accelerated basis and to abandon the second strand of the Siberian gas pipeline.

While developments at the Summits remain fresh in the minds of the participants, the President wishes to once again review the credit initiative and the December 30, 1981 sanctions and decide on one of the following options:

OK	No		
____	____	1.	Lift the December 30, 1981 sanctions on oil and gas equipment exports to the USSR governed by existing contracts.
____	____	2.	Maintain the December 30 sanctions as presently constituted.
____	____	3.	Extend the December 30 sanctions to include subsidiaries and licensees of U.S. companies abroad.
____	____	4.	Approve on an exceptional basis U.S. export licenses for the Sakhalin project.

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Review June 16, 1988

Lies at Versailles

Believing honesty is the best policy, *The Economist* offers an alternative communiqué which should have been issued by the seven free-world leaders last week at Versailles

As the heads of the governments of the United States, France, Great Britain, the Federal Republic of Germany, Japan, Italy and Canada we are concerned that the communiqués of the previous seven summits have grown ever more vapid. They give the impression that we all agree on pretty well everything. That is not true, and our electorates know it. Our credibility is not helped by an all-purpose communiqué. To try to get out of this trap, we have decided to tell the truth about our discussions at Versailles.

First, some areas of broad agreement. Most of us remain attached to open trade. This is partly because our advisers tell us that it is theoretically good at boosting growth and curbing inflation. More practically, we dislike being criticised by each other when our own protectionist policies cause jobs to be lost in an important constituency of one of our fellow summiteers. Peer group pressure is influential. Six of us noted with satisfaction that we have extracted a new package of liberalising measures from Japan. We do not think it was bold enough for a country that will run a $10 billion-15 billion external surplus this year, so we are not too effusive in our praise. More next year.

Energy, so Chancellor Schmidt keeps reminding us, was a theme at every one of the eight summits he has attended. The rest of us defer to his long experience, and not simply out of politeness. Energy prices in West Germany have been allowed to rise to reflect world prices, while German inflation is 5½% and falling. Canada, we note, has deliberately kept its oil prices below world levels. Its inflation rate is 11½% and rising. We made Mr Trudeau feel embarrassed about this.

On our economic dealings with the Soviet Union, we were pressed to accept some meaningless phrase about pursuing "a prudent and diversified economic approach . . . consistent with our political and security interests". Since this means that Europeans and the United States are deeply divided, we felt we ought to say so. The American position sounds clear enough: in uneasy peacetime, jaw-jaw should not be accompanied by more-more. The Europeans cannot understand why this principle should apply to everything except American grain sales to Russia. Only last month, a few miles up the road in Paris, American negotiators considered offering Russia a $1 billion credit to buy grain from the farm states (where Republicans hope to keep Democrats at bay in this November's mid-term elections). President Reagan argued that the Europeans should none the less go slow on the Siberian gas pipeline, even though many jobs will be affected in Hesse and Scotland, where Mr Schmidt and Mrs Thatcher also face elections fairly soon.

Our disagreement on east-west trade extends to north-south questions as well. The French and the Canadians are keen on "global negotiations", where every north-south subject will be up for grabs. They asked us all to say that "the launching of global negotiations is a major political objective approved by all participants in the summit". Actually, some of us will not approve if those negotiations are then handed over to the United Nations, on a one-country, one-vote basis. Since that is what many poor countries understand by "global negotiations", such words at Versailles would simply have raised false hopes.

Growthmanship

And so to the main theme of our summit. We were asked to sign a statement that

> growth and employment must be increased. This will be attained on a durable basis only if we are successful in our continuing fight against inflation. That will also help to bring down interest rates, which are now unacceptably high, and to bring about more stable exchange rates.

We demurred, saying that we had rolled such phrases down from seven summits already, during which time unemployment had doubled, prices had risen by about 75%, interest rates had almost doubled, and exchange rates grown more volatile. Instead, we thought it more helpful to discuss why we had failed so badly in the past.

France, and to some extent Canada, believed that Keynesian cures should be tried again—boosting demand and holding the inflationary lid down by price and wage controls. They, along with Italy, were also the only countries still suffering from double-digit inflation: the rest of us were too polite to say so. At the other extreme, we noted that Britain's alternative remedies had produced the highest unemployment rate. Some of us thought that enough to damn the Thatcher experiment; others ventured that it was too early to be sure. Secretly we were all delighted that France and Britain are acting as rival laboratories.

We were again impressed that Japan and West Germany have the lowest inflation and the lowest unemployment rates: no trade-offs there (and no great swings in policy either). More puzzlingly, the United States boasts the large fiscal deficits that Keynesian Canada and France would like, plus some of the monetary restraint that Japan and West Germany have achieved and that Britain aspires to. By pleasing everybody a bit America has found a formula for pleasing nobody at all. That is a moral we thought we could make more of when we get home.

All our domestic policies combine to influence the exchange rates between our currencies. The French tried to pretend that we had agreed to some grand new currency plan—"the reconstruction of the international monetary system" was how one French minister put it at a press conference. We did nothing of the sort. The Americans continued to insist that they would not intervene in foreign exchange markets. Strangely, though, this now barren territory may yet see some fertile growth: our advisers tell us that they are working on a new approach to currency stability that could conceivably satisfy both the Americans and the French (see page 71).

Such a miracle is a long way off. For now, we have no great breakthroughs to offer the world—only a belief that honest disagreement openly arrived at is the least bad way of making economic policy. In this new spirit of truthfulness we will move next year to our ninth summit—and the first in the United States.

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TAGS: ENRG, IT
SUBJECT: COLOMBO'S CALL ON THE SECRETARY: SIBERIAN
- PIPELINE

1. SECRET - ENTIRE TEXT.

2. THE MFA'S ENERGY COORDINATOR, BORGA, ON JUNE 15 TOLD EMBASSY'S ECONOMIC MINISTER THAT HE HAD PREPARED A BRIEFING PAPER ON THE SIBERIAN PIPELINE FOR FOREIGN MINISTER COLOMBO TO USE WHEN HE MEETS WITH SECRETARY HAIG. (BORGA SAID THE SAME PAPER HAD BEEN GIVEN TO SPADOLINI BUT WITHOUT THE SAME EXPECTATION IT WOULD BE USED.) EVIDENTLY COLOMBO SHOULD PRESS FOR A QUICK, POSITIVE U.S. DECISION ON THE USE OF U.S. TECHNOLOGY FOR THE PUMPING STATIONS ON THE SIBERIAN PIPELINE. BORGA EXPRESSED HIS BELIEF THAT THE U.S. WOULD SO DECIDE; WE RESPONDED THAT WE WOULD NOT CARE TO MAKE A PREDICTION.

3. BACKGROUND. THE ITALIANS HAVE TWO BALLS IN THE AIR REGARDING THE PIPELINE. THEY HAVE NOT YET SIGNED AN AGREEMENT TO PURCHASE GAS AND THE CURRENT EXTENSION OF THEIR OPTION RUNS OUT JULY 1 -- BUT THE SOVIETS, BY ALL REPORTS, WILL EXTEND THE ITALIANS' OPTION. THE ITALIAN DECISION ON THE SOVIET GAS PURCHASE IS HOSTAGE TO THE CONCURRENT GAS NEGOTIATIONS WITH ALGERIA. LATE LAST WEEK FOREIGN TRADE MINISTER CAPRIA VISITED ALGIERS WHILE, AS A RESULT OF CAPRIA'S VISIT, ALGERIAN ENERGY MINISTER NABI IS SUPPOSED TO COME TO ROME JUNE 23, IT APPEARS THE ITALIANS AND ALGERIANS ARE STILL FAR APART ON PRICE. ONLY A GOI SUBSIDY COULD QUICKLY END THE STALEMATE; AND WITH THE GOI DEFICIT ALREADY OVER 70 TRILLION LIRE (ABOUT 52 BILLION DOLLARS), THIS MUST BE DIF-

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FICULT TO CONTEMPLATE. BUT MOST OBSERVERS BELIEVE THE PSI WILL NOT RELAX ITS OPPOSITION TO THE SOVIET GAS DEAL UNTIL THE ALGERIAN CONTRACT IS CONCLUDED.

4. THE OTHER UNDECIDED POINT IS NUOVO PIGNONE'S CONTRACT TO PROVIDE SOME OF THE PUMPING STATIONS FOR THE SIBERIAN PIPELINE. HERE THE SOVIET PRESSURE FOR A QUICK ITALIAN DECISION IS FIERCER. NUOVO PIGNONE HOPES THAT IT WILL BE ABLE TO PROCEED USING GE-DESIGNED ROTORS (PRODUCED EITHER BY GE, IF THE U.S. GREATLY RELAXES ITS ATTITUDE, OR BY ALSTHOM-ATLANTIQUE, IF THE U.S. TAKES THE MIDDLE WAY OF TURNING A NELSONIAN EYE TO WHAT IS DONE OUTSIDE THE U.S.). AS NOTED IN PARAGRAPH 2, THE ITALIANS APPEAR TO BELIEVE THE USG WILL ADOPT ONE OF THESE TWO POLICIES.

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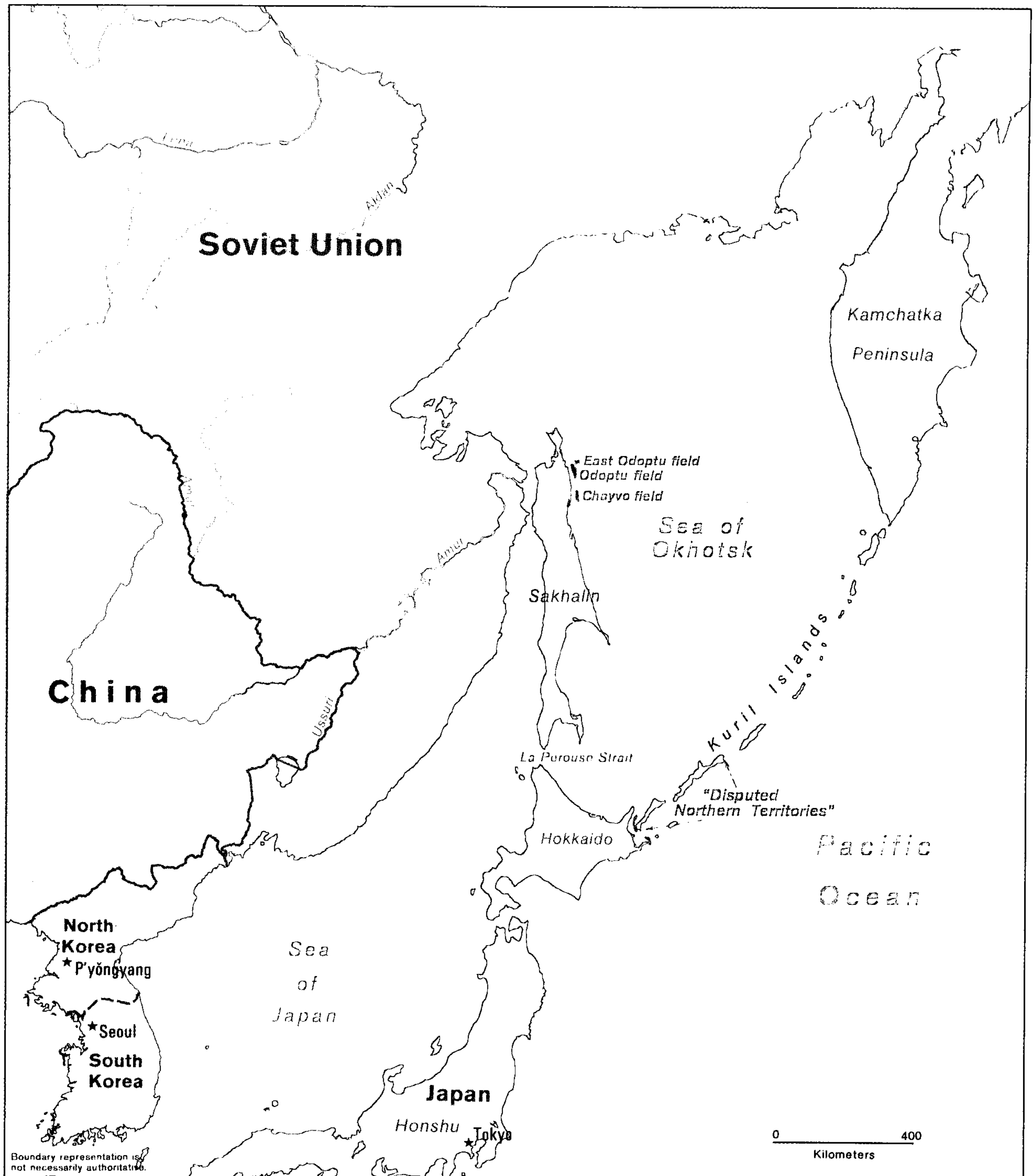

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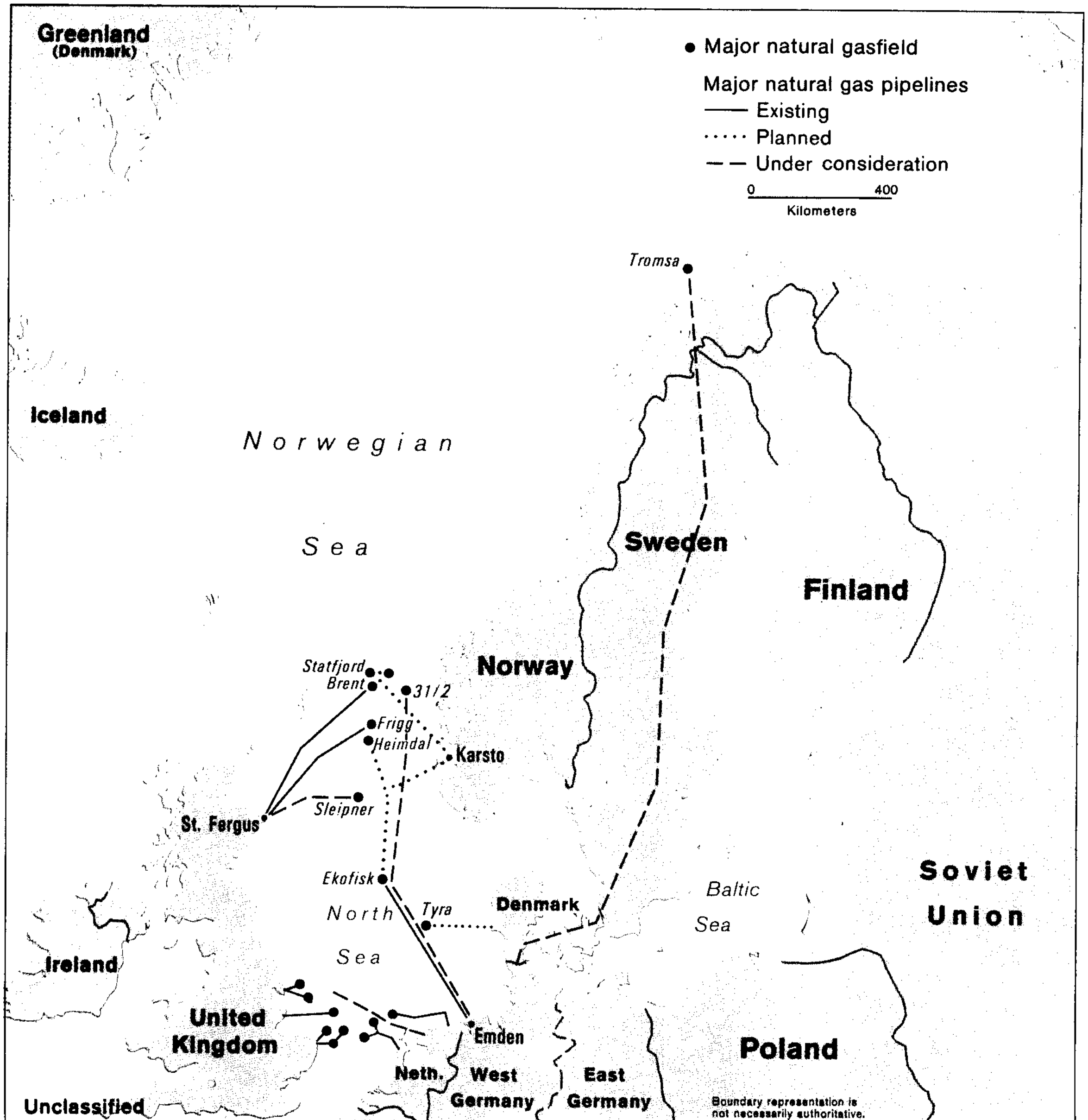
North Sea: Natural Gas Pipelines



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Europe: Major Natural Gas Supply Routes

Unclassified

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NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

SECRET ATTACHMENTS

June 16, 1982

Dear Mr. Buckley:

I am pleased to attach for your information the technical material which you requested on the Sakhalin and West European Soviet pipeline projects. The CIA was responsible for the background paper. This paper was reviewed by officials from State (EB and EUR), Commerce, DOD, DOE and NSC. I have added an executive summary under my own responsibility.

Yours sincerely,

Bill

William F. Martin

Attachment

The Honorable James L. Buckley
Under Secretary for Security
Assistance, Science and Technology
Department of State
Washington, D.C. 20520

SECRET ATTACHMENTS

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Director of
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Western Alternatives to Soviet Natural Gas: Prospects and Implications

Special National Intelligence Estimate

Secret

SNIE 3/11-82
28 May 1982

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SNIE 3/11-82

WESTERN ALTERNATIVES TO SOVIET NATURAL GAS: PROSPECTS AND IMPLICATIONS

Information available as of 27 May 1982 was used in the preparation of this Estimate.

THIS ESTIMATE IS ISSUED BY THE DIRECTOR OF CENTRAL INTELLIGENCE.

THE NATIONAL FOREIGN INTELLIGENCE BOARD CONCURS.

The following intelligence organizations participated in the preparation of the Estimate:

The Central Intelligence Agency, the Defense Intelligence Agency, the National Security Agency, and the intelligence organizations of the Departments of State and Energy.

Also Participating:

The Assistant Chief of Staff for Intelligence, Department of the Army

The Director of Naval Intelligence, Department of the Navy

The Assistant Chief of Staff, Intelligence, Department of the Air Force

The Director of Intelligence, Headquarters, Marine Corps

The Department of Commerce

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KEY JUDGMENTS

The USSR's great need for hard currency and its massive natural gas reserves give Moscow a strong incentive to offer cheap gas to Western Europe and, to a lesser extent, to Japan. The Europeans and the Japanese, for their part, are attracted by the low Soviet prices, as well as by the diversification of their energy supply sources away from Middle East oil that is entailed in buying Soviet gas. The Europeans claim that present and anticipated dependence on Soviet gas does not involve serious risk, and potential Japanese dependence is minimal. The problem is that Moscow will try to sell even larger amounts of gas in the 1990s to relieve its hard currency problem.

US actions to encourage development of Western alternatives to Soviet natural gas can help to limit the volume of gas exported to Western Europe and to reduce the possibility of additional purchases of Soviet gas in the longer term.

Under agreements already signed or likely to be signed soon, the USSR will increase its gas exports to Western Europe to the oil equivalent of more than 900,000 barrels a day by the late 1980s. This would be equivalent to about 25 percent of West European gas consumption, including 25 to 50 percent in those countries (West Germany, France, Italy, Austria, and possibly Belgium) that would be buying Soviet gas. It would represent about 3 percent of total West European energy consumption. Gas exports, about one-half from the Siberian pipeline, would yield the USSR around $10 billion a year in hard currency after 1990, when the loans would have been repaid. If West European demand for Soviet gas falls below the levels established in the new contracts, purchases can be cut by as much as 20 percent, which would reduce Soviet hard currency earnings by up to $1 billion a year.

The development of alternative Western energy sources—particularly the large gas resources of the North Sea—will take too long to have much effect on the West European demand for Soviet gas in the 1980s but could determine whether or not Western Europe seeks additional Soviet gas in the 1990s. Although, at best, an additional 150,000 to 250,000 b/d oil equivalent of new supplies could be delivered by 1990 through increased Dutch and Norwegian production, estimated Norwegian gas reserves are sufficient to permit a large expansion of production in the 1990s.

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However, if these reserves are going to be available at a reasonable cost, steps must be taken soon to encourage and stimulate their development. Western governments would have to make major decisions on field development, distribution systems, and pricing. While most projects will proceed on the basis of commercial merit, existing government development policies in Norway, the United Kingdom, and the Netherlands will have to be altered to permit a sizable increase in gas flows before the early 1990s. Favorable tax policies and some type of interest rate subsidy would also speed development and lower the cost of delivered gas from remote fields requiring high capital investments. With the exception of increased coal use, most other alternatives available to Western Europe are now viewed as too costly or potentially insecure.

If the Soviets sell all of their share of LNG and most of their share of oil from the planned Sakhalin development project, Japan could receive by the early 1990s up to 60,000 b/d of oil and 75,000 b/d of oil equivalent as liquefied natural gas (LNG). The USSR would earn some $1 billion a year in hard currency. Japan's dependence on Soviet gas would be small, and Japan could easily forgo the proposed volume of LNG from the Sakhalin project. Alternative supplies from several sources are expected to become available, and there is growing concern that contracted supplies may already exceed demand in the Japanese market.

Although no additional purchases of Soviet gas beyond those already contracted for have been discussed—or, according to some European governments, are intended—continued expansion of gas exports to the West is extremely important to Moscow. The USSR's hard currency earnings are likely to stagnate or decline in the 1980s even if Western Europe imports the full contracted amounts of Soviet gas. Reduced West European purchases would make a decline in Soviet import capacity even more likely. Although the USSR could develop other exports by the 1990s, none look anywhere near as promising or profitable as gas exports. Consequently, the absence of large new deals for Soviet gas would probably significantly restrict Moscow's access to Western equipment and technology in the long term and make Soviet policy decisions for military programs more painful.

As West European imports of gas from the USSR increase, so will European dependence. Nevertheless, the extent to which this increased dependence can be translated by Moscow into meaningful leverage over European policies is uncertain. Although Moscow has cut off (or manipulated) energy exports to other countries in the past and could

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certainly do the same in the future, to do so would mean forgoing badly needed foreign exchange earnings.

At the very least, the Siberian gas pipeline deal will enhance Moscow's ability to influence the West Europeans on issues which the latter see as peripheral to their own security interests. Moscow will be able to dampen enthusiasm for economic sanctions sponsored by the United States in retribution for Soviet actions elsewhere. The USSR has already threatened Western Europe with the loss of energy and other projects if it joined in either the Afghanistan- or Poland-related sanctions. The Soviets must tread lightly in the 1980s so as not to alienate their European customers in ways that would motivate them to develop alternative supplies. In the 1990s, however, if the Soviet–West European gas relationship were substantially expanded, it would give Moscow even more clout on questions of this sort.

European vulnerability to interruptions of Soviet gas supplies could be mitigated by development of emergency gas reserves, gas grid flexibility, a capacity to quickly increase gas production, and a capability to switch to alternative fuels. As dependence on Soviet gas continues to increase, however, building a safety net adequate to prevent substantial economic disruptions if Soviet gas supplies were cut off will become very difficult and costly.

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